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The Effectiveness and Economic Development Impact of
Policy-Based Cash Transfer Programs: The Case of Jamaica

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SUMMARY

From 1973 to 1980 the Jamaican economy suffered a severe economic decline resulting from lower prices for bauxite and alumina and a major loss of its key export markets for those products. To make matters worse, the Jamaican Government instituted a number of policies that ended up reducing investment, manufacturing output, and exports. At the same time, the government's fiscal deficit was taking an ever-growing share of gross domestic product (GDP).

In 1981, with the election of a new government, Jamaica was ready to tackle its economic problems, and the Agency for International Development (A.I.D.), the World Bank, and the International Monetary Fund (IMF) were ready to support a major policy reform effort. While the new government was eager in principle to tackle the reforms, actual implementation was slow and major reforms did not take hold until 1984/ 1985.

During the 1981-1987 period, A.I.D., the World Bank, and the IMF provided massive assistance. However, Jamaica's economy was slow to revive. Part of the problem was the slow (and at times inadequate) pace of economic reform. Probably more important, however, were international factors. Jamaican exports account for over 40 percent of GDP, and markets for bauxite and alumina, which had generated over 70 percent of Jamaican export earnings, were declining during the 1970s. While that decline looked serious, it was greatly overshadowed by the severe bauxite market collapse that began in 1982. From 1979 to 1985 bauxite export volume was cut in half and the real unit price of those exports also fell by half. As a result, GDP continued to decline during most of the reform period. Only in 1986/1987 did growth pick up.

As a result of policy changes, Jamaica has been steadily increasing agricultural and manufacturing output, as well as its exports of manufactured goods and other non-bauxite products. Tourism earnings have also increased. However, these increases have not been enough to replace the major earnings loss from the collapse of the bauxite market, which had accounted for a major share of GDP and export earnings. Even though Jamaica has instituted a number of policies and incentives to encourage other industries, the economy has

been slow to respond to its major structural loss. Many of the new crops and industries are growing rapidly, but they are starting from a very small base.

BACKGROUND OF THE PROBLEM

Jamaica advanced rapidly from its independence in 1962 until the early 1970s on the strength of its bauxite resources, tourism, and the traditional export crops of sugar and bananas. The economy is small and highly dependent on international trade: imports account for over 40 percent of GDP. Given its vulnerability to external shocks, Jamaica must take international supply, demand, and price signals seriously. However, until recently the country followed an inward-looking, protectionist policy. A high degree of tariff protection along with licensing and price controls supported the small, generally inefficient manufacturing sector.

In the 1973-1980 period, the government attempted a comprehensive social and economic reform. Land redistribution, increased social welfare services, direct measures to relieve unemployment, and extensive Government intervention in areas such as agriculture and tourism, which had previously been left to the private sector, were major elements in this effort. Food subsidies and an overvalued Jamaican dollar penalized agriculture, while the bauxite/alumina industry was crippled by the 1974 production tax, which had a devastating long-term impact on new investment.

Such comprehensive social and economic initiatives might have been economically viable in a country with a large domestic market or a secure and growing export market. Jamaica had neither. As an added problem, the 1970s and early 1980s were a time of international economic upheaval, with two major oil price shocks, two worldwide recessions, and sharp swings in international commodity demand and prices.

From 1973 to 1980 the Jamaican Government's share of GDP increased from 25 to 43 percent, and by 1979 the fiscal deficit was 17 percent of GDP. GDP declined in every year, falling a total of 18 percent by 1980. Manufacturing output fell by 28 percent. Gross domestic capital formation fell from 32 percent of GDP to only 15 percent. Large and sustained current account deficits were financed by foreign borrowing, which reduced net international reserves from \$37 million to minus \$532 million. Inflation, unemployment, social unrest, and capital flight were serious problems, as was the growing exodus of skilled workers and professional people.

A.I.D.'S ASSISTANCE APPROACH

In 1980, after 7 years of protectionist policies and social experiments, the Jamaican economy was in a severe decline. The elections that year brought to power a new government that was politically and economically much further to the right. It was committed to private enterprise, export promotion, and sound management of the country's finances. Due to the economic morass created by the previous government, the new government had a mandate for economic change. The time was ripe for A.I.D. support of policy reform.

A.I.D. support for policy reform came primarily through the Cash Transfer program under the Economic Support Fund. The Cash Transfer program, in addition to meeting Jamaica's economic needs, supported important U.S. political and commercial concerns. The Jamaican Government was viewed as an ally that could play a key role in the achievement of U.S. objectives in the Caribbean Basin.

To stop the downward economic spiral and to get back on a growth track, the Jamaican economy needed a major overhaul. A.I.D. assistance had three objectives: (1) to stabilize the Jamaican economy while minimizing the contraction in domestic production and employment, (2) to support structural reforms necessary for broad-based economic growth, and (3) to ease the burden of adjustment for the most vulnerable segments of the population.

The A.I.D. Cash Transfer program focused on reforms designed to reduce Government involvement in commercial enterprises, reduce Government production controls and disincentives, maximize the role of the private sector in national development, and encourage export-led growth. Central to this strategy was increased reliance on the market mechanism for allocating resources and on rational sectoral interventions to increase exports and generate employment. A.I.D. Cash Transfer assistance was complemented by IMF and World Bank stabilization and structural adjustment programs. Together, these resource flows have been extraordinarily large.

A.I.D. POLICY REFORM MEASURES AND THEIR ECONOMIC IMPACT

Economic Stabilization

Fiscal, monetary, and exchange rate policies were discouraging savings, investment, and exports. The Government was slow to implement stabilization measures, failing to comply with MT performance criteria in FY 1983 and FY 1984. However, major improvements were in place by FY 1985, and the economic benefits were evident by the end of 1987 (the time of this evaluation).

The foreign exchange rate moved from an overvalued fixed (and at times multiple) rate to a unified floating rate. The

fiscal deficit was improved by reducing government expenditures, improving the efficiency of public enterprises, and divesting money-losing public sector operations. From FY 1982 to FY 1987 the overall government deficit as a percentage of GDP fell from 17.1 percent to 5.5 percent. Monetary growth was restrained, and consumer price inflation declined from 21.1 percent to 7.7 percent. However, because Jamaica waited until FY 1985 to take effective stabilization measures, the adjustment process was more difficult and the negative impact on short-term growth was greater than it otherwise would have been.

Income Tax Reform

Jamaica's income tax system was regressive, failed to raise needed revenue, and encouraged uneconomic activities. The income tax system was inequitable, complicated, and tended to promote high levels of avoidance and evasion. It encouraged the movement of capital and labor from the formal to the informal sector and to the self-employed sector. It encouraged high debt/ equity ratios, low investment relative to consumption, and a large and growing underground economy. The tax system was inelastic and unable to mobilize needed Government revenues.

As a result of conditionality provisions of the Cash Transfer program and A.I.D. -financed technical assistance, Jamaica reformed both the personal and corporate income tax systems. The new system is a simplified, broad-based tax system that eliminates almost all exemptions, credits, and loopholes while applying a single, flat tax rate of 33 1/3 percent. Tax avoidance and evasion have been reduced, and the system is generating increased revenue. The inappropriate economic incentives of the old system have been eliminated, and business optimism, investment, and profits are on the rise. Jamaica's tax reform has been a major A.I.D. policy success.

Divestment of Public Sector Commercial Enterprises

Starting in the early 1970s, the public sector expanded rapidly and came to encompass a wide range of economic functions, many of which it performed inefficiently and at high cost. The expansion during that period reflected the previous government's policy of promoting the role of the state in the economy, creating employment, and expanding social and economic services. By 1982 there were 537 separate statutory bodies including public utilities, banks, and financial services; authorities dealing with transportation, hotels, imports, exports, and marketing; and public entities involved in production activities in bauxite/alumina, sugar, bananas, meat, winter vegetables, cement, garments, shoes, furniture, and commodity trading. By the early 1980s, the inefficiencies and high costs were becoming more evident: the 15 largest entities were running a combined deficit equal to 6.7 percent of GDP.

Starting in 1982, every Cash Transfer agreement has included divestment requirements. By the time of this evaluation, 20 firms had been sold or their assets had been leased to the private sector. Another 13 firms were at various stages of negotiation leading toward eventual privatization. On the negative side, the process has been much slower than expected and not all divestments called for in the Cash Transfer agreements have been achieved. Some have been held up by the Jamaican Cabinet for political reasons. On the positive side, in 1986 alone, privatization generated over \$25 million from the sale and lease of assets and the elimination of government subsidies. Added to that amount is the \$10-\$30 million a year the government has received from the public sale of common stock in government-owned corporations. Even more important has been the improved efficiency (from better pricing, management, wage rates, technical processes, and the like) achieved by the newly privatized firms.

Market Reform

Over the years a growing number of commodities were placed under price controls or received price subsidies, leading to inefficiencies in resource use and allocation. Starting in 1984, Cash Transfer conditionality provisions required the elimination of some specific price controls and a ban on new price controls. However, while some controls and subsidies were eliminated, other controls have been added and many prices are still set by the government or maintained through government subsidies. For example, the pricing and allocation decisions of the state-owned Jamaica Commodity Trading Corporation, which has a monopoly on the import and marketing of many essential commodities, often fail to reflect market realities.

On balance, Jamaica's compliance with Cash Transfer conditionality provisions concerning market reform has been much less than complete. With only limited policy reform success, the economic benefits of freer markets have yet to be achieved.

Encouragement of Traditional Agricultural Exports

The production and export of traditional agricultural crops had fallen due to an over-valued foreign exchange rate and inefficient state-controlled export marketing organizations. During the 1970s, output of crops sold on the domestic market increased nearly 4 percent per year, while that of agricultural export crops (sugar, bananas, coffee, cocoa, pimento, and citrus) declined by 4 percent a year. Farmers found that it did not pay to produce crops for export. Although other factors--notably the overvalued exchange rate--played a role, the poor performance of traditional agricultural exports was due in large part to the restrictive effects of the state-controlled export marketing

organizations.

The export marketing organizations had monopoly control and pricing over all export crops. They used producer resources to fund their own money-losing production activities and high-cost services (e.g., extension, pesticide spraying, fertilizer distribution). When international prices rose, they failed to pass the increase on to farmers.

Cash Transfer conditionality provisions included requirements to increase competition in the marketing of traditional export crops. This included deregulation of coffee exports, elimination of the Banana Board, and an agreement not to impose new regulations on pimento, citrus, and cocoa.

Under the reform program, control of non-marketing activities (e.g., production and extension) was removed from marketing organizations. Growers and traders were allowed to purchase and export. The banana company was restructured, and export marketing organizations lost sole purchasing authority for cocoa, coffee, and citrus. A price formula for coffee and cocoa, based on world prices minus costs and retentions, was developed to ensure that higher prices resulting from devaluations were passed on to producers.

Banana exports increased from a low point of \$1.5 million in 1984 to \$9.1 million in 1986, and the number of acres planted has more than doubled. The coffee industry has attracted foreign money, and plantings were up sharply in 1986. Exports of citrus rose from \$1.1 million in 1984 to \$2.0 million in 1986.

While devaluation and deregulation have increased banana, coffee, and citrus investment and exports, many smaller producers are not yet taking advantage of new opportunities. This creates a dilemma for policy-makers: since the farmers and traders are not fully responding to the reforms, either the policy reforms are inadequate or there are other market obstacles that are still blocking change.

Nontraditional Exports

Traditional Jamaican exports had limited growth prospects. New exports were needed. A.I.D.'s strategy has focused on increasing economic growth by shifting the Jamaican economy from its long-standing public sector, import-substitution bias toward an emphasis on private sector, export-led growth. The removal of import restrictions, restrictive marketing regulations, and price controls was intended to promote expansion, especially of nontraditional manufactures and agricultural exports. As an indication of response to these measures, as well as to the exchange rate devaluation, nontraditional exports to non-Caribbean Common Market (CARICOM) countries have more than doubled, from \$80 million to \$173 million. While initial progress has been good, it

started from a very low base and the absolute amounts are still small.

Import Liberalization

Jamaica's protectionist import policy encouraged unproductive and inefficient industries. In 1980, 364 items were subject to quantitative import restrictions. Import tariffs were high (with effective rates of protection ranging up to 200 percent), complicated (numerous duty exemptions), and tilted against export industries. Cash Transfer conditionality provisions concentrated on the removal of quantitative import restrictions and a rationalization of the import tax system.

The number of items subject to quantitative restrictions has been reduced from 364 to about 55, and the maximum effective rate of protection has been reduced from 200 percent to 68 percent. Duty exemptions were removed for some items. The IMF, World Bank, and A.I.D. successfully pressed for a unified, freely fluctuating exchange rate.

These changes generated an increase in manufacturing production of 9.7 percent between 1983 and 1987, compared with a 28-percent decline between 1973 and 1980. Within the manufacturing sector, food processing, textiles, chemicals, and some nonmetallic and metal-based products made major gains. Between 1980 and 1985 exports of manufactures increased 5 percent a year, and nontraditional exports to non-CARICOM markets increased 15 percent annually.

There has been considerable, if uneven, progress on import policy reform. The improved import system has supported a reorientation of Jamaican industry toward exports and an improved investment climate. While the economic impact to date is limited, and anomalies in the system persist, the economy should start to see greater benefits from import reform in the next few years.

Encouragement of Private Investment

Foreign exchange controls on capital flows, the investment approval process, and excessive red tape and restrictions on private sector decisions were major obstacles to increasing private investment. Jamaica's new growth strategy required investments to increase capacity in both agriculture and manufacturing.

As a result of Cash Transfer conditionality provisions, studies have been completed on the investment climate and a Joint Ministry Investment Committee has been formed. The three bodies involved in investment promotion have been placed under one agency, but have not been merged in practice. Results of promotion efforts are hard to measure, but investment approvals have increased and export promotion efforts have had some success. Obstacles to investment

remain, but the overall economic climate has clearly improved since the 1970s. This is still faint praise, however, given that the climate in the 1970s was so poor. There clearly remains room for much greater improvement.

Social Impact and Equity Effects of Adjustment

Low-income groups are often least able to deal with the austerities created during a period of adjustment. Jamaica's stabilization and adjustment programs altered production, employment, and public services. The impact on different income groups and sectors of the economy varied. Available evidence indicates a considerable drop in living standards after the adoption of the strongest part of the stabilization program in FY 1985. Government budget cuts have fallen heavily on social services, particularly education and health. Retrenchment in Government spending was inevitable because of prior imbalances. A.I.D. Cash Transfer assistance almost surely reduced the amount of austerity required.

In the short-term, conditions for consumers worsened, but the deterioration was far less than would have been experienced without the Cash Transfer program. Middle- and lower-income households have been hard-pressed to maintain their standard of living, and the poor have been hard hit by the cuts in social services.

The pain from adjustment has been severe and has had a reverse equity tilt. In the longer run, when the new policy reforms have fully worked their way through the economy, low-income groups should benefit from increased employment opportunities, rising income, and more public services from a government that has the resources to reach those most in need.

FINDINGS

Economic Stabilization

While the Jamaican Government was slow to implement necessary reforms, they were eventually implemented and the economy was placed on a sounder footing. A.I.D. stabilization policy reform efforts (closely linked with IMF and World Bank conditionality provisions) were a success.

Income Tax Reform

In most countries, entrenched political and economic interests resist changes in their country's tax system. Surprisingly, labor, business, both political parties, and the Jamaican Government were able to agree on a comprehensive tax reform that eliminated nearly all exemptions and loopholes, reduced tax evasion, improved equity, and restored appropriate economic incentives. The A.I.D.-supported tax reform program was a major policy

reform success.

Divestment of Government Enterprises

The pace of privatization has been slow, but enterprises that have been sold to the private sector have generated immediate cash flows for the Government, while reducing the level of future Government subsidies.

Improved Markets and Reduced Subsidies

There has been only limited success in freeing markets from excessive Government controls and regulations. Several commodity and service subsidies and price controls have been eliminated, but new ones continue to be established.

Trade Liberalization

While initial progress on export promotion has been good, it started from a low base and the absolute amounts are still small. On the import side, reform is encouraging but impact, so far, has been limited. Overall success on trade policy reform may be some years off.

Private Investment

It appears that the correct policies are being put in place, but investment has been slow to respond. Whether the policies go far enough and whether they are appropriate and sufficient will not be known for some time.

The Rate of Progress

Although Jamaica has made progress toward removing marketing, price, trade, and other controls, not all actions called for under A.I.D. and World Bank programs have been fully undertaken. However, this is not for lack of trying. Jamaica has done about as well as could have been expected with its limited resources. Moreover, entrenched attitudes and systems do not yield easily to new ideas and decrees, no matter how sensible they appear to economists. Maintenance of progress toward policy reform goals may well be more important than meeting specific targets at specified times.

LESSONS LEARNED

A small developing country like Jamaica "lives or dies" on world demand for its exports. Jamaica had a one-commodity economy, with bauxite/alumina making up over 70 percent of export earnings. Jamaica's share of world bauxite/alumina production has been in a state of long-run decline. It fell from a peak of 75 percent of world production in 1960 to 14 percent in 1979 and only 7 percent in 1985. From 1979 to 1985 the downward trend became more severe as Jamaican bauxite/alumina export volume fell by over 50 percent.

During that period, the "real" international price of aluminum fell by 50 percent. For Jamaica's economy, the collapse of the world bauxite market overwhelmed all other factors.

Major economic dislocations require major structural adjustments. Jamaica's economy took a severe beating with the decline of its major export commodity. When faced with such a situation, a country must either improve export earnings of that commodity (by reducing costs and increasing volume) or move into new exports. Given the sheer enormity of the loss, Jamaica needed to make major changes.

While some changes have been instituted in Jamaica's bauxite industry, production costs and volume have yet to turn the corner. Jamaica has increased its manufacturing output and nontraditional exports, but both started from a very low base and are far from filling the large gap left by the loss of bauxite/alumina earnings. The lesson in this case seems to be that major economic losses require major new investments and new economic efforts. This requires time. While the restructuring has started, the full benefits will be some time away.

Donors can misjudge the situation too. The demand for industrial raw materials like aluminum is closely related to the business cycle. In 1981 most experts believed that the demand for bauxite would spring back strongly after the international recession ended. They did not anticipate the depth of the worldwide recession (the most severe in 50 years) or the changes in the bauxite market that were making Jamaica much less competitive. Thus, donor-supported economic reforms (particularly exchange rate and fiscal policy reform) were much weaker than they should have been. Had the reforms started sooner and been stronger, the process might have been less painful. Economic recovery lagged, and a much greater reform effort was required in 1984 and 1985.

Donors should consider ways to ease the equity impact. The austerity programs, as necessary as they were for restoring stability and providing a basis for growth, have resulted in declining living standards and a deterioration in social services. The declines became more severe as policy reform intensified during the 1984-1986 period. Donors might have done more to lessen the effect of the reforms on the poorest parts of the population. Policy interventions to influence the host government's selection of budget areas for reductions might be considered in future Cash Transfer programs.

Natural disasters can undo even the best of efforts. After years of decline, Jamaica had made a number of important policy reforms and was turning the corner toward improved economic growth. Then, in September 1988, Hurricane Gilbert did multi-billion dollar damage to the country and the

promising economic recovery may be stopped in its tracks.

OUTSTANDING ISSUES

Economic Interdependence Events of the 1980s have brought home the tremendous importance of external factors to a small country's development prospects. The worldwide recession of the early 1980s, along with increased energy costs, inflation, and major swings in prices and demand for primary commodities, put nearly all developing countries under pressure. Those that were heavily dependent on international trade and investment suffered the most.

Debt Overhang

During its downward economic spiral, Jamaica borrowed heavily from international banks and aid donors. Jamaica has been steadily improving its economic policies and laying the basis for a return to more rapid economic growth. However, it has had difficulties servicing its large foreign debt. Even after several debt reorganizations, Jamaica can barely pay the interest, let alone the principal. This same problem also applies to many other developing countries. The problem (and the solution) is international and will have to be dealt with in a much broader context.

This summary, by Joseph Lieberman, is based on an evaluation study of the Jamaica Cash Transfer program. The study, which was sponsored by A.I.D.'s Center for Development Information and Evaluation, was completed in November 1987, and the judgments are based on data available at that time. The views and interpretations expressed herein are those of the author and should not be attributed to the Agency For International Development. Any comments or inquiries about this evaluation should be sent to the Center for Development Information and Evaluation, Bureau for Program and Policy Coordination, Agency for International Development, Washington, D.C. 20523-1802.